RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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June 13, 1984 LETTER 889

June 1 DJIA 1124.35; PTI 1600; A-D Ratio -20.79
June 8 DJIA 1131.25; PTI 1598; A-D Ratio -20.79

**THE MARKET:** Two weeks ago all the indices and averages from the S & P 500 to Value Line to the A-D ratio broke to new 1984 lows. In other words, everything confirmed on the downside. As far as Dow's Theory (or any other theory based on the ACTION of the market is concerned), this is a primary bear market.

The Mansfield (weekly) chart shown on this page depicts head-and-shoulders tops in both the D-J Industrial and Transportation Averages. Although obviously not infallible, H & S tops provide projections or counts, and the downside measurement for Industrials is now 1010 while the downside measurement for the Transports is roughly 400. The H & S top is one of the most reliable chart patterns, and downside counts tend to be reached during bear markets.

A goodly number of market analysts are now waiting for the widely-promised "second leg of the bull market." Since this is a confirmed primary bear market, I am afraid these analysts are going to have a bit of a wait. I am mindful that the trend can change (without a bell ringing on Wall Street) and I am also aware that "the market can do anything."

This is the reason that I have been so careful to keep subscribers abreast of the action of my Primary Trend Index (PTI). If the trend is going to turn, if somehow the tide reversed to the upside a few weeks ago, then we will see that turn reflected in the action of the PTI. The history of the PTI tells us that it gives its reversal signals only rarely, and this is as it should be, since the primary trend of the market changes only rarely.

The PTI topped out on January 17, 1984, it smashed below its 21-week moving average on February 6 (at which time I stated unequivocally, "Get Out") and as of this writing the trend of the PTI continues down.

The easiest way of following (investing with) the stock market is simply to follow the trend of the 21-week moving average of the PTI. The moving average is constructed exponentially, so that as soon as the PTI rises above the MA the MA turns up. Since February 6 the MA has been sliding, and that was our fail-safe bear signal. Can stock market investing be reduced to following the direction of a single line? The action of the moving average of the PTI is as close as I've ever been able to get to that kind of "simple investing."

I have been reading a good deal of "what must happen" before this bear market ends. Some analysts insist that there must be an all-out panic, a period of capitulation. Others state that yields on the Dow must go to such-and-such level. Still others look for a low in their cyclet studies. I will stick to the precepts of Dow Theory plus the fail-safe insurance of my PTI.

I want to again review my five gauges or barometers of the primary trend.

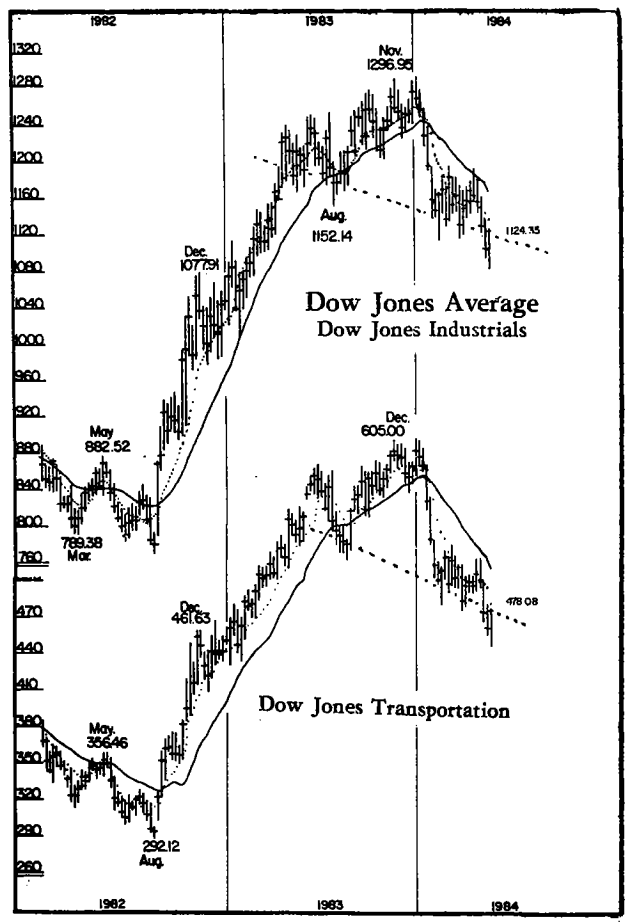
(1) The Dow Theory states that we are in a bear market.

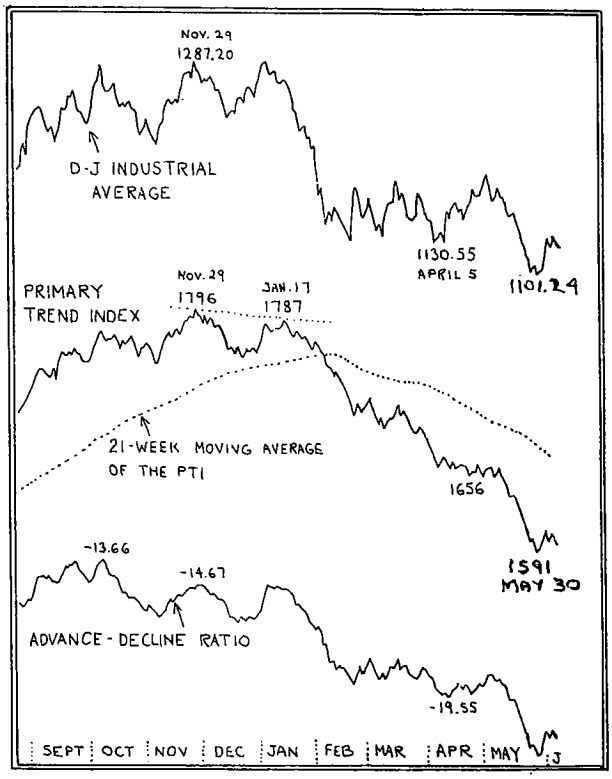
(2) The Trendex "Long-Term Probability Patterns" turned bearish on February 1, and it's still bearish.

(3) The Lowry Buying Power/Selling Pressure lines are still bearish, and a short-term buy signal was recently aborted.

(4) The latest issue of the *Bank Credit Analyst* begins: "Fundamental trend of the stock and bond prices remain down; further sharp deterioration in indicators." Their debit/loan ratio (which tends to forecast the direction of corporate profits) is now plunging, and it's in a decidedly bearish mode.

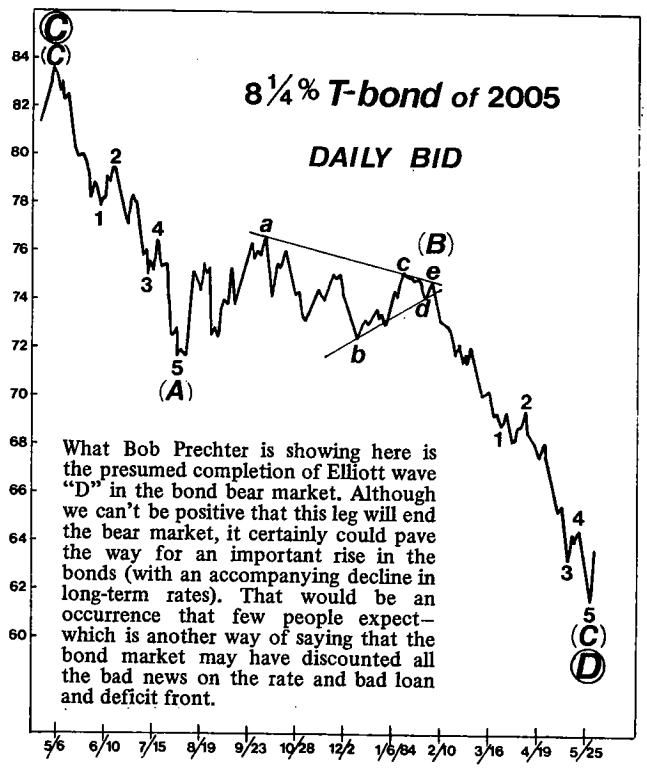
(5) Last but not least, my PTI (based strictly on market action) holds in the bearish mode, although its downward momentum may have been arrested over the past few weeks.






Conclusion: My studies indicate that the primary trend of the stock market is bearish.

There is one situation which I want to go into here–in the midst of the stock market section. I include this item because it has such a direct bearing on the stock market. This is a chart from Bob Prechter's latest issue of Elliott Wave Theorist, PO Box 618, Gainesville, GA 30503. Bob is an old friend and one of the finest technicians in the business (and I take special interest in Bob's work because many years ago I urged him to go into the advisory business).


8¼% T-bond of 2005
DAILY BID
What Bob Prechter is showing here is the presumed completion of Elliott wave "D" in the bond bear market. Although we can't be positive that this leg will end the bear market, it certainly could pave the way for an important rise in the bonds (with an accompanying decline in long-term rates). That would be an occurrence that few people expect–which is another way of saying that the bond market may have discounted all the bad news on the rate and bad loan and deficit front.
5/6 6/10 7/15 8/19 9/23 10/28 12/2 1/6/84 2/10 3/16 4/19 5/25

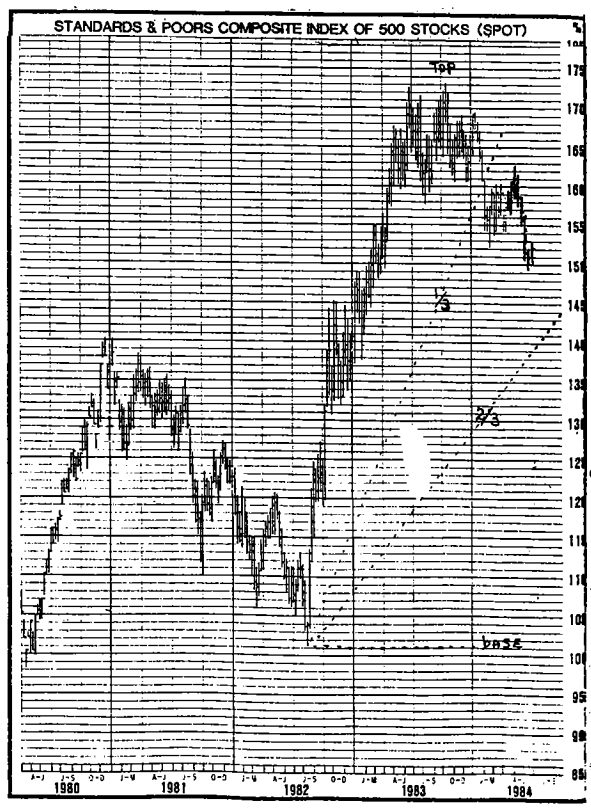
What we see here is Prechter's chart of the (typical) 8¼ T-Bond of 2005. Things could change, but right now Prechter believes we have a perfect Elliott count down to an important bottom in the bond market. Bob has been bearish on bonds for a long time, but at this point he believes that a major bottom could be at hand. At worst, it looks to me as if bonds should be ready to base and rally (and the psychology is perfect, since point D on the chart occurred in the midst of a super-bearish atmosphere for bonds).

Obviously, a bond advance at this point would be a major plus for the stock market (and even during a bear market a bond advance is a positive factor for the market).

**THE PICTURE:** Let's face it, this is not a happy picture. This is a weekly chart of the broad S & P 500, and here's what we see. At the highs we see a one year area of distribution lasting throughout 1983 and into the first few weeks of 1984. Next the ("hopeful") rally to the 163 level March and April. And finally, we see the smash to new lows which occurred in late-May.

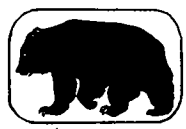
The question–where to next? Obviously, nobody has THE answer, but one of the best guidelines was provided many years ago by that great analyst, Edson Gould. Gould invented the "speedline," a device based on distance and time. How does the speedline work? First, we draw an imaginary vertical line from the base of the move to the top. Then we divide that line into three equal parts. Next we draw a trendline (speedline) connecting the base and the 1/3 intersection of the vertical line. And we draw another speedline connecting the base and the 2/3 level of the vertical line. This gives us the two speedlines shown on the chart.

As a rule, correction will come down to touch the first or 1/3 speedline. As you can see, the S & P 500 did that in the fifth week of 1984. The 500 broke right through the 1/3 speedline.



When that occurs, the usual expectation is for the price movement to rally back towards the 1/3 speedline, and then to decline and attack the 2/3 speedline.

What's my guess as to how matters will work out? My guess is that this market will rally off the current oversold bottom (a rally which began on June 1). The rally will run out of steam somewhere during late-June or July. Then the market will come back and break the June 1 lows, and at that time we could see the S & P 500 come down and test the 2/3 speedline. If, and I say IF, the 2/3 speedline holds that would be a very good sign and could signal the end of the bear market.



**INVESTMENT POSITION:** With the bond market oversold and NOT making new lows, we have the background for an upward correction in the oversold stock market. But the primary trend is bearish, and that means we stay in T-bills, money market funds and other liquid areas. Note how far below its 21-week moving average the PTI has fallen. This suggests a rally and perhaps an approach by the PTI to its MA. In the stock markets, the defensive area is strongest with particular emphasis on the Food Group. The Big question area is the Big Banks. These optimists are still taking in their third world loans at 100 cents on the dollar. As a result, Wall Street is only paying P/E ratios of 3 to 5 for these clowns.

**MARKET THOUGHTS:** (1) One of the great market worries has been that due to rotten loans the US banking system was about to go under. It is obvious (on the basis of Fed action in the Continental Illinois situation) that the Fed stands squarely behind the large banks in the system. These banks will not be allowed to go belly up, regardless of their financial problems. This realization set off the rally which began on June 1. The market's explosion constituted a "sigh of relief" on the part of Wall Street. Certificates of deposit from the major money center banks, it seems, are almost as good as T-bills.

(2) With every magazine and newspaper now publishing technical comments on the market, it may be that fundamentals and value considerations will become increasingly important. On this basis, the bond/stock relationship still presents a giant problem for equities. For instance, the price/earnings ratio for the Dow is 12.9. Translated into yield, the reciprocal (100 divided by 12.9) is 7.7. Compare this "earnings yield" with the yield on Treasury bonds of 13.5% or the yield on AA rated municipal bonds (general obligations) of 10.3%, and–well, there's just no comparison.

(3) Last year I published a number of studies on the momentum (12 month rate-of-change) for the Standard & Poor's 500. I have just received a further study of the 500 momentum from old friend Bill Menker. Bill shows that following any major rise in S & P momentum (such as last year's rise), the ensuing decline in momentum should be monitored carefully. Since 1953 there have been nine major momentum declines, each one taking S & P momentum well below the zero line. Once dropping below zero, it has taken anywhere from 4 to 19 months for the S & P 500 to hit its final bottom (average time was 9 months). Last month (May) the S & P momentum dropped decisively below zero. This suggests that the very earliest we can look for a final bottom in the S & P 500 would be this September. The longest time elapsed in this study was 1974, when it took 19 months following a momentum drop below zero before the market hit its final bottom.

(4) Everybody is bearish on the bond market. In fact, a few reports have stated that we are seeing the end of the bond market as we know it.

Yet here comes *Marketrends* (Butcher and Singer, 1615 Northern Blvd, Manhasset, NY) written by two top technicians, Dick Yashewski and Joe Barthel, and they note that their NYSE 10-day high-low indicator and their NYSE 10-day A-D oscillator have posted "oversold readings slightly deeper than their September '81 and August '83 bests." In short these indicators have recently registered signals consistent with prior important long-term and intermediate term bottoms. So I ask myself, wouldn't it be funny if the bonds were making a major bottom and nobody knew it?

(5) My old friend, Joe Granville, isn't kidding around these days. He's not just super-bearish, he's talking about closing down the NYSE. Joe sees 200 million shares (on the downside) ahead and 20 to 50 point drops in the Dow. Yes, he's talking about a crash this year. Granville thinks a crash could be set off by a major (bank) failure somewhere, or by the Exchange just closing down because it can't handle downside volume.

What do I think? The odds are *always against* the once-in-a-lifetime incident occurring. But the market can do anything, and Joe obviously thinks this is the year when that anything is going to happen. Also, it's a bear market, and in bear markets the unexpected events tend to appear on the downside. But a crash? Well, who knows?

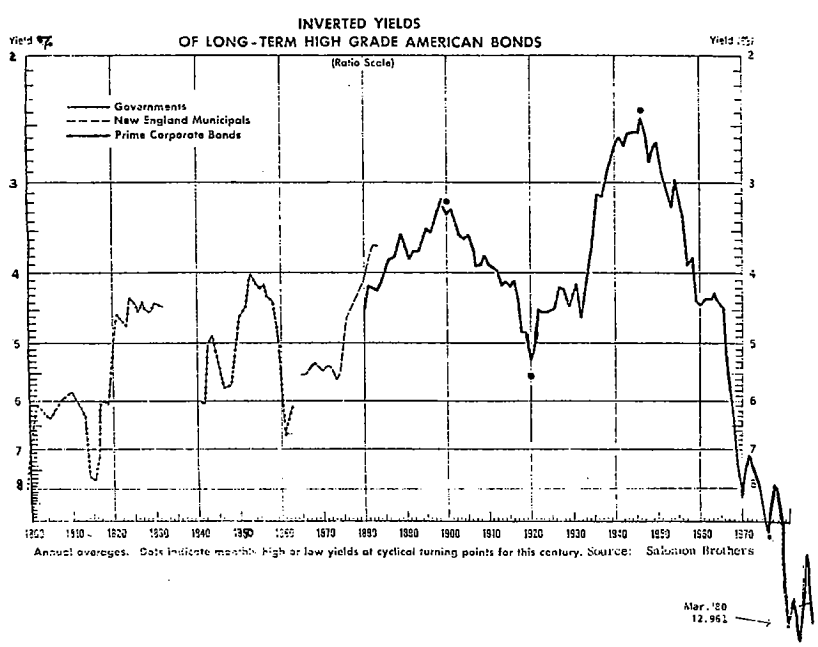
(6) One of the best economic reports in the nation is the Industry Forecast written by S. Jay and David Levy, Box 26, Chappaqua, NY 10514. Their current report is particularly interesting. The Levys see the trend of corporate "profits down for the next three quarters and see a declining rate of inventory accumulation." Furthermore, the Levys believe because today's higher interest rates are hurting housing, other domestic economic activities and third world economies, that all this "increases the great probability that (interest) rates will plunge below 1983 lows later this year." As far as inflation is concerned, the Levys state that "prices generally will rise at a rate of about 3% during the remainder of 1984."

So in all, the Levys see low inflation, a big slide in interest rates, and a declining trend for corporate profits during the rest of 1984. Pretty contrary, what?

**BEGINNING OR END?** I've had this chart so long that I forget who originally published it (I think it was the Old Salomon Bros.). At any rate, it offers a fascinating perspective on interest rates and the bond market. Here we see long-term high-grade bond yields over a period of 180 years, from 1800 to the present (I have obviously up-dated this chart).

The most significant part of the chart is the period from 1945 to the present, a period in which long-term bond yields rose from the 2.5% area to the current 13.5% area.

What's the significance of the rise? Well, for one thing we can see that wars force governments to borrow. This accounts for the increase during and around WW I when interest rates rose from just over 3% to over 5%. Interest rates declined dramatically


INVERTED YIELDS
OF LONG-TERM HIGH GRADE AMERICAN BONDS
(Ratio Scale)
Governments
New England Municipals
Prime Corporate Bonds
Annual averages. Dots indicate monthly high or low yields at cyclical turning points for this century. Source: Salomon Brothers

during the Great Depression of the 1930s. Next came WW II, and the rise of mountains of debt due to the War, and due to the new philosophy of "universal welfare" and everyone's right to almost everything.

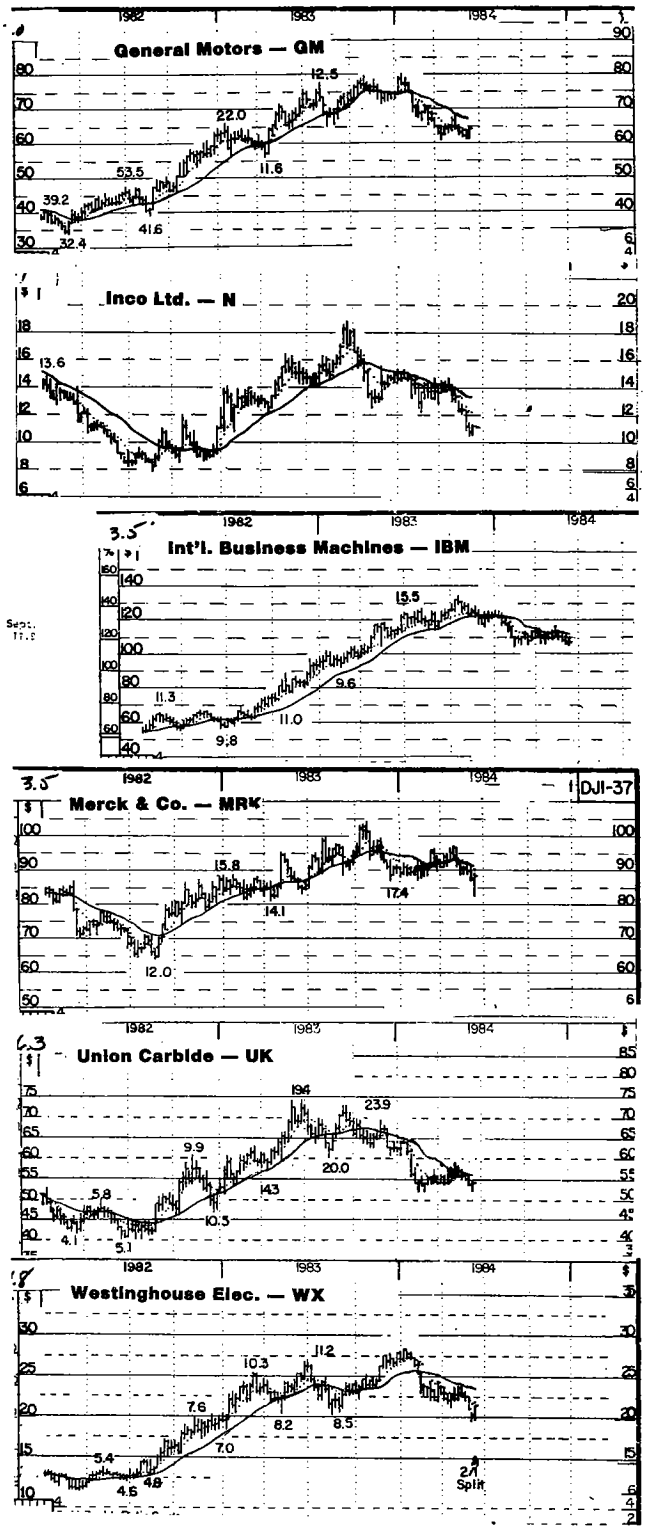
At any rate, it is instructive to realize that the total federal debt was roughly $16 billion in 1929. Today it is $1.5 trillion. Thus, we can compare a period (1929) when the US population was about 125 million, and today's period when the population has about doubled. As for the debt, the percentage of increase is too embarrassing to even mention here.

All this has caused a heart attack in the long-term bond market. The indication of the heart attack is the cost of money. The price for that money, "the rent", is the interest rate. And the rates are at the point where the lender doubles his money (at 13.5%) in just over 5 years!

My own feeling is that we're close to the time when something drastic is going to happen. Now, I'm not saying that that drastic something is going to be bad. Not at all. I'm saying that something very fundamental is going to have to be done soon, or the markets (meaning the cost of money) are going to knock this nation to its knees.

Will taxes be raised? Will expenses be cut? Will the Defense Department be reorganized? Will the draft be reinstated? I don't know. But interest rates cannot be successfully manipulated for long, and the US interest rates are telling me that we're against the wall. Next year should see changes, and those changes will have to be fairly drastic. Otherwise, the bond market is going to pin the politicians against the wall. That wall will be recession, unemployment and tough times for business. All that plus a declining standard of living for Americans. The bond market is saying, "I'm mad as hell, and I'm not going to take it much longer."We'll see, but you've got to admit that it's getting interesting.

**STOCKS:** Although I haven't mentioned it recently, I have a quarter-century habit of running through the chartbooks in an effort to get a feel for the market. Glancing through Mansfield this week I see a lot of tops in the big Dow stocks. I show some of those tops here.




As a rule, when you see big tops like the ones on IBM or Carbide, those tops give way to "wash-out" declines. We see this process in the Inco chart, and a hint of it in the Merck chart. There is no rule about it, but my expectation would be that before this bear market is over almost all the premium stocks will spill on the downside. Of course, most of the speculative and low-grade stocks have taken dives already. But bear markets usually end with the big fellows taking their lickings. It hasn't really happened yet.

**NOTES & QUOTES:** Reading: I came upon this book in a curious way. A few weeks ago while in Los Angeles I visited my ex-father-in-law, the well known writer and college professor,

Max Lerner. I combined the visit with a get-together with my actress daughter, Betsy. Lerner was staying (as he has for many years) with his old friend Hugh Hefner at the Playboy Mansion. So off I went to the Mansion with Betsy to see grandpa.

The Playboy Mansion and its high-security grounds can only be described as fantastic (meaning a fantasy in every sense of the word). The property is gorgeous: rolling lawns, hills, lovely trees. Among other things it contains a whole private zoo, with a large variety of exotic birds and animals (the spectacular parrots are perched all over the lawns). A covey of playgirls were sunning themselves by the huge pool, a pool that meanders through the estate (and yes, the playgirls were interestingly dressed, or should I say undressed).

We found grandpa Max in his room, and as expected, he was deep in his writing (he's written more than a dozen books including the classic "America as a Civilization"). Max has his own room at the Mansion, and he escorted us all through the estate (a trip that requires about an hour). Finally, we talked books, and Max told me that I "had to read" a great new book entitled "Modern Times" by Paul Johnston (Harper & Row). I bought the book the next day, and I am already halfway through it. I must say that the book is amazing, fascinating, informative, and a valuable asset for anyone who is even faintly interested in the past and future of this country and the world. Max calls Modern Times "The book of the '80s."

Oh yes, I met Hugh Hefner for a few minutes (he seems very shy), and I did take a swim in the pool. Unhappily I did not have my bathing suit with me, but happily I was wearing a bathing suit type pair of shorts and none of the bunnies appeared shocked by them. Finally, buy that book–it is extraordinary.

* *

Ah, and a late note. Back in Letter 876 I did a little piece on the fearsome "Mr. T" of the TV program, "The A Team." Betsy just called to tell me that she is currently doing a part on an A Team episode. She also informs me that "Mr. T is great; he's exactly like he is on the TV program." To which I answered, "Just don't get him angry with me!"

* *

If, if you ever get to San Diego (or if you live here), I am going to offer some information. First, don't buy prints for your living room, don't buy junk pictures or reproductions. Down in Balboa Park opposite the Art Museum is the San Diego Art Institute. Here they have carefully chosen originals by local artists (a new exhibit every month). I have visited these exhibits for years, and they are getting better and better. And the prices for this original art (framed) is very modest. You can get all kinds of original oils, watercolors and mixed media art at anywhere from $100 to $1000. You'll be getting original art, some of it very good, and you will be helping living artists. I urge you to visit the Art Institute.

Everybody knows about the great San Diego Zoo and the equally fabulous Wild Animal Park and the outstanding Sea World, and our fabulous weather. But few know that we have the world's best salad bar restaurant, where you can get all the salad you can eat (the salad counter is 70 feet long with an amazing variety) for under five bucks. This includes a variety of desserts including Belgian Waffles with Strawberries and whipped cream (the dessert alone is worth the price of the meal). It's all on Claremont Blvd. Our local Bully's restaurant gives you a full dinner at prices from $5 to $10, and visitors swear they've never seen a better bargain. We're now crawling with Oriental restaurants of all types from Thai to Cantonese. But someday, somehow, some great chef from New York is going to pack it in, get in his Cadillac, and head out to San Diego to open our first great French or Italian restaurant. He should be an instant millionaire. This town of one million is ready–and there is nothing here to compare with New York's best–NOTHING.

* *

Here's an addition to my fascination with statistics.

Percentage of Jewish children that attend college . . . . 80%.

Number of wars currently being fought throughout the world... 42!

Percentage of new restaurants that fold in the first five years . . . . 75%.

Average number of bank hold-ups in LA per day . . . 8 (making LA the bank hold-up capital of the world).

Cans of Pepsi the company must sell to recoup the cost of the new $5 million Michael Jackson commercial: 875 million cans.

Total owed to US companies by Iran in the form of government-backed credits: $7.2 billion. Total owed by Libya: $2.2 billion. And finally, total owed by Russia $28.7 billion. All proving that politics and economics don't necessarily sleep in the same bed.

Number of number-one picks in this year's NFL draft that were white (Caucasian): only an incredible six out of 28 or 21%. (are blacks naturally better or do they just try harder?).

In 1983, 139.9 million commodity contracts were traded, among them 11 million in gold. Value represented by those 11 million gold contracts was $500 billion!

* *

Parameters: This darn word is probably the most misused word in the English language, and stock market analysts are the worst offenders. The word they should be using is perimeters, which means the outside bounds ("the perimeters of the current trading range"). Parameters is a mathematical term meaning a "variable constant." So fellows, please, let's get rid of parameters. Put it back in your college math textbook. The word is PERIMETERS!

* *

What's the most overpriced item in America? I'm voting for the ice cream cone. After WWII I could get a cone anywhere for $.05, and I remember a Buick costing around $1800. Today cones cost anywhere from $.85 to $1.60 (I hear that's what you pay in NYC), although a fancy cone out here comes in at $1.25. Now a lot more technology and advancement goes into a Buick than goes into a cone so where do our merchants get off boosting the price 1000% to 1500% for cones whereas Buick's price is up maybe 600%. I've stopped eating cones–out of health reasons and out of protest. Anyway, ice cream contains everything bad for you–lots of salt, sugar and animal fat.

**NOTE:** The response to my offer to Xerox copies of the historical chart books of the D-J Averages and the A-D ratio has been surprisingly large. I want to repeat that offer. I offer two albums (1) the three D-J Stock Averages with the D-J 20-Bonds and volume going back to 1885, daily, a page for each year plus notations of major news events on each page. Price for this album in a heavy 3-ring binder (each page is 11" X 17") is $120. The

By Felix G. Rohatyn

I have been in the investment banking business for 35 years. I was a governor of the New York Stock Exchange and chairman of its so-called "Crisis Committee" in the late 1960s, the so-called "Go-Go years." I make my living doing mergers and acquisitions, and by giving advice to corporate America. What is happening in the financial markets today bears the same relationship to what happened in the "Go-Go" years of the 1960s as Caesars Palace bears to the local church bingo game. Every kind of financial instrument is being created to lure individuals into believing they are investing when they are really speculating. Variable-rate mortgages to give the home buyer the illusion he has a cheap mortgage; options, straddles, commodity futures, foreign-exchange contracts, venture-capital funds, "Junk bonds." We are turning the financial markets into a huge casino.

Individuals are not the only speculators. A transaction called "leveraged buy-out" has swept corporate America. This transaction essentially turns public companies into private companies mostly by borrowing against their own assets and shrinking their equity dramatically. Thus a public company with, say, $100 million of debt and $900 million of equity is turned into a private company with $900 million of debt and $100 million of capital.

This has two consequences, both highly speculative. First, it bets the company on a combination of continued growth and lower interest rates, with no margin for error. Second, it substitutes debt for permanent capital, which is exactly the opposite of what our national investment objectives ought to be.

These LBOs have increased in size, culminating in Esmark's $2.5 billion transaction announced this month and the proposal to take Gulf Oil private for $12 billion some time ago. Although I have no hard numbers, I would guess that, up to now, more than $10 billion of such transactions have taken place. Credit has come from banks and pension funds, whose investment advisers want to outperform the competition. If, in the next year or two, we run into an inflationary recession, with higher interest rates and lower economic activity, there are going to be major casualties in this field. Pension-fund managers will wonder why they did not simply buy 12% government bonds, and banks will have another major loan restructuring area. This is speculation on a major scale.

In the field of takeovers and mergers, the sky is the limit. Not only in size (four recent oil company transactions alone added up to about $35 billion), but in the types of large corporate transactions, we have often gone beyond the norms of rational economic behavior. The tactics used in corporate takeovers, both on offense and on defense, create massive transactions that greatly benefit lawyers, investment bankers and arbitragers, but often result in weaker companies and do not treat all shareholders equally and fairly. The new vocabulary of our business is a reflection of this development: Two-tier tender offers, Pac-Man and poison-pill defenses, crown-jewel options, greenmail, golden parachutes, self-tenders all have become part of our everyday business. They are wonderful for the profitability of our business in the short run, but I believe they are reaching a point where the integrity of our financial markets is in question, and, after all, that has been the basis of the success of our free-enterprise system. In the long run, we in the investment banking business cannot benefit from something that is harmful to our economic system.

I have no specific answers to these trends except to note that bubbles always burst. Tighter regulations on the use of credit or the tax deductibility of interest in certain transactions, reform of takeover regulations, tighter standards on uses of pension funds will, sooner or later, be the result of what is happening today.

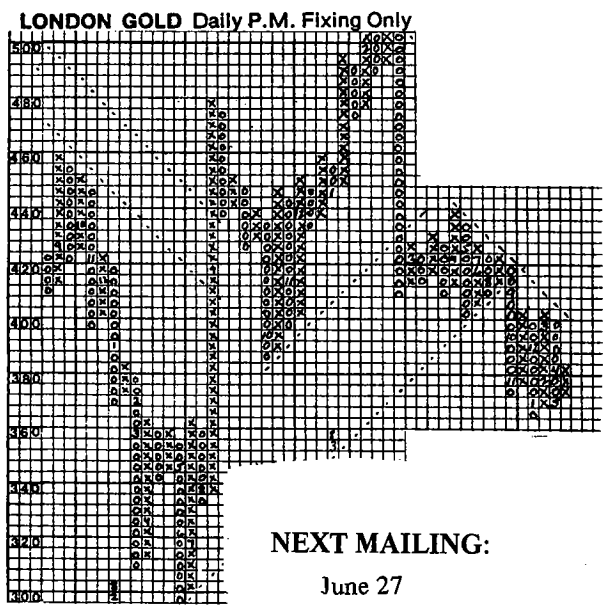
Feliz Rohatyn is a senior partner of Lazard, Freres & Co. He is also the fellow who put NYC back together when it was about to sink into the slime of impossible debt. I thought this piece (above) should be read and studied by every one of my subscribers. It appeared in the WSJ a few weeks ago.

**LATE NOTES:** I seldom include any economic fundamentals in this late section, but I just . . received a one-page mailing from Industry Forecast (S.J. and David Levy). The page is headlined, "Recession in 1984," and they state that it is "highly probable" that a recession will begin before 1984 is over and it may even be underway by the third quarter. I would not dismiss this prediction lightly. If it does occur, I would say that it could be a mean one with a further major squeeze on the stock market and maybe substantially LOWER bond yields. ... In the meantime, my PTI closed the week ending June 8 at 1598, just 7 points above its May 30 low for the year

**GOLD:** Columbia University's widely followed inflation model is now in the "up" mode, which means they see rising inflation. The index of sensitive commodity prices is in a decisively rising trend. And last week my ratio of gold to common stocks gave a definite signal in favor of gold over stocks. And perhaps most important, the foreign currencies are breaking out on the upside—meaning that the dollar is weakening. In other words, the background is right for a rise in precious metals.

BUT—that's just the background. Veteran subscribers know that I am ruled by the price action, not by the sentiment indicators and not by the background considerations.

The gold picture (price movement) remains boringly the SAME. This chart by Chartcraft (Larchmont, NY) says it all. It's going to take a move by gold above 408 to turn the picture bullish. Gold has had every chance to move above 408, but so far—nothing. On the other hand, a drop to 364 will probably set off a new and major decline in gold. But all is not lost in the precious metals area—the price of Rolex watches has recently taken a big pop on the upside.




album is a treasure trove of knowledge for the serious market student. (2) The daily history of the A-D ratio going back to 1931, a page for each year, also in a large 3-ring binder. Price is $90.00. Both albums are up-dated each year, and I know of no finer study source for investors or speculators. Make checks out to Richard Russell, please.

**NEXT MAILING:**

June 27